Introduction to GASB Statement No. 45: *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*

WHAT ARE OTHER POSTEMPLOYMENT BENEFITS, AND WHY ARE THEY IMPORTANT?

Other postemployment benefits (OPEB) are benefits other than pensions, provided to former employees, and are a form of deferred compensation. The State of Idaho provides postemployment benefits as part of the total compensation offered to attract and retain the services of qualified employees. Employees earn the benefits during their years of service but will not receive the benefits until after their employment with the State ends. The State currently provides postemployment benefits such as disability income, health care insurance continuation, and life insurance. Idaho also indirectly subsidizes retiree health insurance by allowing retirees to continue in its group health insurance plan.

Why Was a New Standard Issued for OPEB?

The Governmental Accounting Standards Board (GASB) has determined that the cost of these future benefits is part of the cost of providing public services today. In the absence of an accounting standard, most governments, including Idaho, do not report the full cost of the OPEB earned by their employees each year, nor do they report information about the nature and size of their long-term financial obligations and commitments related to OPEB. Consequently, the readers of financial statements have incomplete information with which to assess the cost of public services and to analyze the financial position and long-term financial health of a government. The purpose of the new standard—GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*—is to address these shortcomings.

Implementation of GASB Statement No. 45 will provide relevant information in Idaho's financial statements about postemployment benefits promised, the comprehensive cost of those benefits, and how Idaho intends to pay for the promised benefits.

How Does Idaho Currently Finance Postemployment Benefits?

In general, postemployment benefits are financed in one of two ways. The actuarial approach entails paying to an OPEB plan an amount that is expected to be sufficient, if invested now, to finance the benefits of employees after they are no longer working for the State. This approach is commonly followed for determining pension contributions.

The pay-as-you-go approach entails paying an amount each year equal to the benefits distributed or claimed in that year. This approach shifts current-year costs to future-year taxpayers. For example, the State will pay for OPEB in 2010 and future years for an employee who retirees in 2010 but provided services to the State from 1985 to 2009. The retiree will no longer be providing services to the State in 2010, therefore not providing services to the taxpayers of 2010. Future taxpayers will foot the bill for the retiree's OPEB under a pay-as-you-go approach. This approach only focuses on the near-term impact of OPEB on the State's operating budget; it does not address the commitment to pay these benefits for many years into the future. Idaho currently follows a pay-as-you go approach for the retiree health insurance implicit rate subsidy.

Plans for long-term disability income, life insurance for disabled employees, and health insurance for disabled employees all have plan assets and are advance-funded by the State on an actuarially determined basis. The plan for long-term disability benefits had no unfunded liability for the fiscal year ended June 30, 2006. Plans for life insurance and health insurance for disabled employees did have unfunded liabilities for the fiscal year ended June 30, 2006.

An implicit rate subsidy exists when retirees and current employees are insured together as a group in a health insurance plan. The premiums paid by the retirees may be lower and current employees' premiums may be higher than they would be if insured as separate groups. By grouping the retirees with the current employees, the State is subsidizing retirees' premiums.

HOW DOES A GOVERNMENT DETERMINE THE COST OF OPEB?

In general, governments should account for and report the annual cost of OPEB and the outstanding obligations related to OPEB in the same manner as they currently do for pensions. These amounts should be produced by actuarial valuations performed in accordance with parameters established by the GASB.

The OPEB Cost: An actuary will calculate expected future benefit payments, then discount those future benefit payments to their actuarial present value—their estimated value if paid today. The actuarial present value generally would be spread over a period that approximates the anticipated years of an average worker's employment with the State.

The OPEB Liability: The actuarial calculations are required to take into account not only benefits expected to be earned by employees in the future, but also those benefits the employees have already earned. The portion of the actuarial present value allocated to prior years of employment is called the **actuarial accrued liability** (AAL).

OPEB Assets: If an OPEB plan has cash, investments, and other resources, these may be applied to fund the actuarial accrued liability if they are placed in an irrevocable trust or similar arrangement. The value of these resources is referred to as the **actuarial value of assets**. Plan assets in the irrevocable trust are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer and plan administrator. Although some Idaho OPEB plans have plan assets, the assets are not held in irrevocable trusts (or a similar arrangement). Therefore, those assets will not be considered OPEB assets, nor will they offset the liability under Statement No. 45.

The Unfunded Liability: The AAL (OPEB liability) minus the actuarial value of assets (OPEB assets) equals the **unfunded actuarial accrued liability** (UAAL) or unfunded liability. The unfunded liability would be amortized (allocated) over a period of up to thirty years (approximately equal to a typical public employee's term of employment), either in level dollar amounts or as a level percentage of projected payroll. The level dollar method divides the liability into equal dollar amounts over the selected number of years; each payment is part interest, part principal. The level percentage method calculates payments so they equal a constant percentage of payroll over time as payroll increases. Idaho currently uses this method when reporting pension benefits.

OPEB Contributions: The OPEB cost and the portion of the unfunded liability to be amortized (allocated) in the current period together make up the **annual required contribution** (ARC) of the employer for the period. Employer contributions consist of payments directly to or on behalf of a retiree or beneficiary, premium payments to insurers, or assets irrevocably transferred to a trust (or equivalent arrangement).

OPEB Expenses, Expenditures, and the Net Obligations: The annual OPEB cost is the OPEB expense that the State would report in its accrual-based financial statements—the government-wide statements and the proprietary fund statements. Generally, the cumulative sum of differences between an employer's annual OPEB cost and the amounts actually contributed to the plan makes up a liability called the net OPEB obligation.

ADDITIONAL CONSIDERATIONS

Bond rating agencies are paying very close attention to the impact of OPEB reporting on the financial condition of a government. The Securities and Exchange Commission has stated that governments are required to disclose OPEB estimates in bond offerings even before Statement 45 is implemented.

The new OPEB standard addresses accounting and financial reporting issues only. The GASB has no power over a government's budgeting and financing decisions; therefore, the decision to place assets in an irrevocable trust is entirely up to each government entity. After an evaluation of the State's current funding approach and the new reporting requirements, the State may opt to place assets in an irrevocable trust in order to avoid an unfavorable result in their financial statements, such as increased liabilities.

The GASB does not require assets to be set aside in a trust. However, any assets not in a trust or other similar arrangement will not reduce the OPEB liability on the State's financial statements. An increase in liabilities due to OPEB reporting could reduce net assets, and potentially cause a downgrade in bond ratings. Since municipalities and school districts rely on the State's bond rating, proper management of OPEB costs is a major concern.

WHEN WILL IDAHO IMPLEMENT THIS NEW STANDARD?

The GASB requires that Idaho implement these new standards for fiscal year 2008, which begins July 1, 2007. Idaho will implement this standard prospectively, meaning that the liability will start at $0 on July 1, 2007, but the liability will grow every year that Idaho does not make contributions equal to the annual OPEB cost.